DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 03-0112
Gross Income & Adjusted Gross Income Tax
For the Years 1998-2000

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ISSUE

I. Adjusted Gross Income Tax— Intangible Holding Companies

Authority: Ind. Code § 6-3-2-2; Ind. Code § 6-8.1-5-1; *Bethlehem Steel Corp. v. Ind. Dept. of State Revenue,* 597 N.E.2d 1327 (Ind. Tax 1992); *aff'd* 639 N.E.2d 264 (Ind. 1994); *Quill Corp. v. North Dakota,*504 U.S. 298 (1992); *Gregory v. Helvering,* 293 U.S. 465 (1935); *Lee v. Comm'r,* 155 F.2d 584 (2d Cir. 1998); *Horn v. Comm'r,* 968 F.2d 1229 (D.C. Cir. 1992); *Comm'r v. Transp. Trading and Terminal Corp.*, 176 F.2d 570 (2nd Cir. 1949); *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993).

Taxpayer maintains that the Department erred when it recomputed taxpayer's adjusted gross income to include one subsidiary on a consolidated basis.

II. Adjusted Gross Income Tax-Net Operating Losses

Authority: *Hi-Way Dispatch, Inc. v. Indiana Dep't. of State Revenue,* 756 N.E.2d 587 (Ind. Tax 2001); *Phoenix Coal Co. v. Comm'r*, 231 F.2d 420 (2d Cir. 1956); *Geoffrey, Inc. v. South Carolina Tax Comm'n,* 437 S.E.2d 13 (S.C. 1993).

Taxpayer protests the disallowance of net operating loss carryforwards for Taxpayer based on combination of Taxpayer's returns with a subsidiary.

III. Gross Income Tax—Small Business Companies

Authority: Ind. Code § 6-2.1-2-2; Ind. Code § 6-2.1-3-24.5; I.R.C. § 1361; I.R.C. § 1362; *Ind. Dep't of State Revenue v. 1 Stop Auto Sales, Inc.* 810 N.E.2d 686 (Ind. 2004).

Taxpayer protests the imposition of gross income tax with respect to two subsidiaries based on their claimed status as small business companies.

IV. Gross Income Tax—Taxability of Intangibles

Authority: 45 IAC 1-1-51; 45 IAC 1.1-6-2; *Geoffrey, Inc. v. S.C. Tax Commission,* 437 S.E.2d 13 (S.C. 1993).

Taxpayer protests the imposition of gross income tax with respect to amounts paid to a subsidiary for the use of its patents and other intellectual property

V. Gross Income Tax-Leasing Income

Authority: Ind. Code § 6-2.1-1-9; Ind. Code 6-2.1-3-3; *Enterprise Leasing Co. v. Ind. Dep't of State Revenue*, 779 N.E.2d 1284 (Ind. Tax 2002); *First Nat'l Leasing & Financial Corp. v. Ind. Dept of State Revenue*, 598 N.E.2d 640 (Ind. Tax 1992).

Taxpayer protests the imposition of gross income tax with respect to lease payments for property leased to Indiana customers.

VI. Adjusted Gross Income Tax-Property Factor

Authority: Ind. Code § 6-3-2-2; *Enterprise Leasing Co. v. Indiana Dep't. of State Revenue*, 779 N.E.2d 1284 (Ind. Tax 2002); *Twentieth Century Fox Film Corp. v. Dep't of Revenue*, 700 P.2d 1035, 1037 (Or. 1985).

Taxpayer protests the inclusion of leased property located in Indiana in the numerator of its property factor for adjusted gross income tax purposes.

VII. Tax Administration--Penalty

Authority: Ind. Code § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of the ten percent (10%) penalty for negligence.

STATEMENT OF FACTS

Taxpayer is an out-of state company in the business of manufacturing and selling forklifts and similar equipment throughout the country. During the years in question, Taxpayer also had three wholly-owned subsidiaries. One of the subsidiaries was engaged in the leasing of Taxpayer's equipment ("Leasing Subsidiary"). A second subsidiary managed Taxpayer's trademarks and patents ("Intangible Subisidiary"). A third subsidiary located in North Carolina was engaged in the manufacture of Taxpayer's products ("NC Subsidiary"). Taxpayer has operated an Indiana sales office for several years and more recently began operations at an Indiana manufacturing facility.

During the years in question, Taxpayer was a small business company within the meaning of Indiana gross income tax laws. However, Taxpayer did not elect S Corporation status for federal income tax purposes.

Taxpayer and Leasing Subsidiary filed consolidated gross income and adjusted gross income tax returns for the years in question. Subsequently, Taxpayer was audited by the Department. The auditor determined that Intangible Subsidiary had nexus with Indiana. As a result, the Department assessed gross income tax against Intangible Subsidiary with respect to its royalty payments. Taxpayer has protested this assessment, arguing that Intangible Subsidiary did not have nexus with Indiana. In the alternative, Taxpayer argues that Intangible Subsidiary's income

was not from Indiana sources, and that Intangible Subsidiary was a "small business company" for gross income tax purposes.

Leasing Subsidiary was also assessed gross income tax with respect to its operations. Taxpayer argues that Leasing Subsidiary's leasing income was not subject to gross income tax based on the fact that it was not derived from Indiana sources. In the alternative, Taxpayer argues that Leasing Subsidiary's income was subject to treatment as a "qualified lessor", and that Leasing Subsidiary was a "small business company."

In addition, the Department required the consolidation of Intangible Subsidiary with the other businesses that had previously filed Indiana returns. Taxpayer argues that, since Intangible Subsidiary did not have Indiana nexus, such combination was prohibited. Further, Taxpayer's net operating loss carryforwards from prior periods were disallowed. Taxpayer argues that the Department is estopped from such disallowance. Finally, the Department assessed penalties with respect to the assessment, which Taxpayer has protested.

I. Adjusted Gross Income Tax—Intangible Holding Companies

DISCUSSION

A. Sham transaction

The "sham transaction" doctrine is well established both in state and federal tax jurisprudence dating back to *Gregory v. Helvering* 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. *Id.* at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." *Id* at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." *Comm'r v. Transp. Trading and Terminal Corp.*, 176 F.2d 570, 572 (2d Cir. 1949). "Transactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. *Horn v. Comm'r*, 968 F.2d 1229, 1236-37 (D.C. Cir. 1992). In determining whether a business transaction was an economic sham, two factors can be considered; "(1) did the transaction have a reasonable prospect, *ex ante*, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" *Id*. at 1237.

The question of whether or not a transaction is a sham, for purposes of the doctrine, is primarily a factual one. *Lee v. Comm'r*, 155 F.2d 584, 586 (2d Cir. 1998). The taxpayer has the burden of demonstrating that the subject transaction was entered into for a legitimate business purpose. Ind. Code § 6-8.1-5-1(b).

Here, Taxpayer entered into an arrangement that bears almost no relationship to business reality. In order to give Taxpayer's and Intangible Subsidiary's arrangement any credence, several items must be accepted. First, Taxpayer was willing to stay in business despite losing tens of millions

of dollars each year. Second, Taxpayer was willing to enter into and stay in an arrangement with a subsidiary wherein the payments made to Intangible Subsidiary were greater than Taxpayer's operating profits. Third, Intangible Subsidiary was able to generate over $30,000,000 per year from royalties from one corporation (Taxpayer), with a total salary expense for three years that totaled little more than a minimum wage salary for a full-time employee for *one year*, and other non-tax expenses (including, presumably, rent, utilities, and other similar expenses) that totaled just over $1,200 for the three year period in controversy. Fourth, the intellectual property that Intangible Subsidiary held had value independent of Taxpayer's sales of property. Fifth, the arrangement between Taxpayer and Intangible Subsidiary had no reason to exist after March, 2000, when Intangible Subsidiary was dissolved, but had plenty of reasons to exist prior to March, 2000. The Department is not inclined to accept the validity of this arrangement for tax purposes.

Taxpayer is, of course, entitled to structure its business affairs in any manner its sees fit and to vigorously pursue any tax advantage attendant upon the management of those affairs. However, in determining the nature of a business transaction and the resultant tax consequences, the Department is required to look at "the substance rather than the form of the transaction." *Bethlehem Steel Corp. v. Ind. Dept. of State Revenue*, 597 N.E.2d 1327, 1331 (Ind. Tax Ct. 1992), *aff'd* 639 N.E.2d 264 (Ind. 1994).. The transfer of the intellectual property and the royalty payments were purely matters of "form" and lack any business "substance."

B. Intangible Subsidiary has Indiana situs

Even if the transaction could not be considered a sham, Intangible Subsidiary's income was Indiana source income when it engaged in transactions related to "exploiting" intellectual property.

Here, the case *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993), though not controlling, is quite persuasive. In that case, a large toy company established a holding company to which it transferred its trademarks. The toy company paid a percentage of its sales to the holding company. The holding company was located in Delaware, but had no employees. *Id.* at 15, n.1. The toy company claimed a deduction for its royalty payments to the holding company for South Carolina corporate income tax purposes, but claimed that none of the royalty payments were South Carolina source income. South Carolina claimed that the holding company had conducted business in South Carolina, while the holding company claimed that taxation of its royalty income by South Carolina was prohibited by the federal constitution pursuant to *Quill Corp. v. North Dakota*,504 U.S. 298 (1992). The court noted that the holding company did business in South Carolina, via the purposeful opening of stores in South Carolina and the toy company's sales of merchandise at its South Carolina stores, through which the holding company derived its revenues. *Id.* at 16-18. Accordingly, the court held that the taxation of the holding company's income was permissible under the United States Constitution and South Carolina law. The Court also distinguished *Quill* by noting the holding company's purposeful activities into South Carolina via sales of merchandise at stores in South Carolina, and by noting that the tax imposed on the holding company was rationally related to the benefits conferred upon the holding company. *Id.*

Intangible Subsidiary was engaged in the business of "managing" intellectual property-property that has no value apart from Taxpayer's sales of equipment. To state that the intangible income derived from the licensing transactions only took place in Nevada, with a mere $3,000-$4,000 of

salary expense and $300-$500 of expenses other than taxes, did not fairly represent the transaction between Taxpayer and Intangible Subsidiary. Taxpayer manufactured and sold equipment for a business, in this state and several other states, and a few foreign countries. Taxpayer derived the benefit of sales made in Indiana of its equipment. To state that the royalty income was income derived only from Nevada was to very conveniently ignore that the manufacturing, sales and service that made the taxpayer a well-respected national company occurred in many states other than Nevada, and that Intangible Subsidiary's own revenues for the royalties necessarily derived from the manufacturing and sales that transpired in this state, as well as many other states and countries, rather than just Nevada. Intangible Subsidiary has entered into Indiana, and the tax rationally relates to its activities in Indiana, and accordingly it is proper to include Intangible Subsidiary on a consolidated return. Finally, Taxpayer and Intangible Subsidiary were a unitary business, and accordingly combination was proper under Ind. Code § 6-3-2-2(l) and (p).

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Net Operating Losses

DISCUSSION

Taxpayer also protests the disallowance of net operating losses incurred by Taxpayer during prior years. In particular, Taxpayer has noted that the Department allowed the carrybacks and carryforwards of net operating losses from 1992 to 1997, the period for which Taxpayer had been previously audited.

While Indiana statutes and case law have not dealt with this particular situation, federal law governing net operating losses have dealt with this situation. In *Phoenix Coal Co. v. Comm'r*, 231 F.2d 420 (2d Cir. 1956), a corporation incurred a net operating loss in 1947. The corporation carried back its net operating losses to eliminate its 1945 income and reduce its 1946 income. The corporation incurred a further net operating loss in 1948, which served to eliminate its 1946 income.

The Commissioner reviewed the corporation's returns. Upon review of the corporation's returns, the Commissioner determined that the corporation had underreported its 1945 income. Accordingly, the Commissioner redetermined the amount of net operating losses that could be carried forward to 1946, and assessed additional tax for that year. At the time of the assessment, the statute of limitations for imposition of additional tax for 1945 had passed, though not for 1946. The court held that, though taxes for 1945 could not be assessed due to the passing of the statute of limitations, the income for 1945 could be redetermined to compute the proper amount of net operating losses allowable for 1946. *Id.* at 421-422.

Here, Taxpayer's contentions with respect to the net operating loss carryforwards cannot be accepted. The Department has sought to revisit the determinations of the proper amount of net operating losses, along with carryforwards and carrybacks, for the prior audit period and any previous years solely for purposes of determining the proper amount of income subject to tax for 1998 to 2000, just as the Commissioner in *Phoenix Coal* recomputed the corporation's income for 1945 to determine the proper income for 1946. This does not permit assessment any year

prior to 1998, just as the Commissioner's redetermination for 1945 did not permit assessment for that year. Thus, the Department was correct in reviewing and redetermining the net operating loss carryforwards available for the years in question.

Taxpayer further argues that the Department is estopped from disallowing the net operating loss carryforwards from previous years that had been previously approved by a Department auditor. The elements of an estoppel defense are: (1) a representation or concealment of material fact; (2) made by a person with knowledge of the fact and with the intention that the other party act upon it; (3) to a party ignorant of the fact; (4) which induces the other party to rely or act upon it to his detriment. *Hi-Way Dispatch, Inc. v. Indiana Dep't. of State Revenue*, 756 N.E.2d 587, 598 (Ind. Tax 2001) (*citing Salin Bancshares, Inc. v. Indiana Dep't of Revenue*, 744 N.E.2d 588, 592 (Ind. Tax 2000)).

Here, the Department apparently allowed a net operating loss. However, Taxpayer did not present any information that would have permitted the Department to review the facts and circumstances of the previous audit, such as the agreement between Intangible Subsidiary and Taxpayer (indeed, it appears that the audit did not even mention Intangible Subsidiary). The Department did not intend Taxpayer to rely on that allowance to affect its normal business behavior, nor did Taxpayer rely on that allowance in its business structure or behavior in the years. Accordingly, the Department is not estopped from disallowing the net operating losses for the period from 1998 to 2000.

Taxpayer also argues that the net operating losses should be permitted prior to the 1997 (Taxpayer's words) decision in *Geoffrey*. However, the decision was decided in 1993. Further, while the application of the decision to the particular fact situation may have been a first, the *Geoffrey* decision cited case law from states back to 1979, *Geoffrey*, 437 S.E.2d at 16 *(citing American Dairy Queen Corp. v. Taxation and Revenue Dep't*, 605 P.2d 251 (N.M. Ct. App. 1979)*; Aamco Transmissions, Inc. v. Taxation and Revenue Dep't*, 600 P.2d 841 (N.M. Ct. App. 1979)), and Supreme Court jurisprudence back to as early as 1920, *Id* at 17, for the proposition that intangibles can be taxed outside a corporation's commercial domicile. As such, Taxpayer has misstated the date of a court opinion, while ignoring the background cases that led to the court decision, in order to attempt to force the Department to accept an artifice of Taxpayer's own creation.

FINDING

Taxpayer's protest is denied.

III. Gross Income Tax-Small Business Companies

DISCUSSION

As a general rule, non-resident corporate taxpayers are subject to gross income tax on their gross receipts derived from businesses and activities conducted in Indiana. Ind. Code § 6-2.1-2-2(a)(2). However, under Ind. Code § 6-2.1-3-24.5(b), a corporation which qualifies as a small business corporation is exempt from gross income tax. For gross income tax purposes, a small business corporation is defined as having the same definition that term has in I.R.C. § 1361(b). Ind. Code § 6-2.1-3-24.5(a). As a general rule, exemption statutes are to be strictly construed against the person claiming the exemption. *Ind. Dep't of State Revenue v. 1 Stop Auto Sales, Inc.* 810

N.E.2d 686 (Ind. 2004) (*citing General Motors Corp. v. Ind. Dep't of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax 1991), *aff'd* 599 N.E.2d 588 (Ind. 1992)).

Taxpayer qualified as a small business corporation within the statutory definition of I.R.C. § 1361(b)(1). However, Taxpayer was not an S-Corporation due to the fact that it had not elected such status under I.R.C. § 1362(a).

Intangible Subsidiary and Leasing Subsidiary were not small business corporations due to the fact that they have a corporate shareholder, which renders them ineligible for small business corporation status under I.R.C. § 1361(b)(1)(B), which limits the scope of permissible shareholders to various persons or entities, but generally does not permit ownership by another for-profit corporation.

Taxpayer maintains that, because the Taxpayer is eligible for S-Corporation treatment within I.R.C. § 1361(b), Intangible Subsidiary and Leasing Subsidiary were eligible by virtue of I.R.C. § 1361(b)(3), which provides that domestic corporations wholly owned by an S-Corporation are disregarded as separate entities, and treated as part of the parent S-Corporation for tax purposes. However, at the very least, such status requires the parent corporation elect to be treated as an S-Corporation, which Taxpayer did not do in this case. Thus, Intangible Subsidiary and Leasing Subsidiary were not small business corporations within the meaning of Ind. Code § 6-2.1-3-24.5(b), and the exemption is not applicable.

FINDING

Taxpayer's protest is denied.

IV. Gross Income Tax— Taxability of Intangibles

DISCUSSION

Taxpayer protests the imposition of gross income tax with respect to its royalty payments made to Intangible Subsidiary located in Nevada.

In this case, two issues must be resolved:

1. Did Intangible Subsidiary have an Indiana situs for its intangibles?
2. Is the whole transaction a sham transaction?

With respect to situs, Taxpayer argues that the intangibles formed an integral part of a trade or business situated and regularly conducted outside Indiana, noting the location of Intangible Subsidiary in Nevada. According to Taxpayer, under Department regulations, the intangible income for Intangible Subsidiary should be attributed to that location.

However, it cannot be said that this is an entirely accurate assessment of Taxpayer's arrangement. Taxpayer's arrangement basically works in this manner: Taxpayer makes a sale of equipment to retailers or customers. Taxpayer in turn took the money and paid to Intangible Subsidiary a percentage of that money for the "right" to use Taxpayer's own name. By virtue of

its control of Taxpayer's name and its exploitation in Indiana, Intangible Subsidiary acquired an Indiana situs.

Taxpayer argues that the auditor's reliance on the *Geoffrey* case cited previously is misplaced, first by noting that the case was decided in another state, and second by noting the regulations stated above. While *Geoffrey* is persuasive rather than mandatory authority in Indiana, the reasoning that the intellectual property has an Indiana situs in this circumstance is worthy of discussion. In the current case, Intangible Subsidiary only derived income upon the sale of goods. This is very similar to the intangible holding company in *Geoffrey*, which the court noted derived its income not from the mere holding of a piece of paper, but rather from retail transactions that the retailer purposely sought. Further, unlike a conventional franchise arrangement in which a holder of a name agrees to allow unrelated third parties to use its name, Intangible Subsidiary only transacted with Taxpayer. To the extent that Intangible Subsidiary yielded its "royalties" as a result of Indiana sales, the intangible formed an integral part of a business regularly carried on in Indiana; thus, the intangibles had a business situs in Indiana, and accordingly were properly subject to Indiana gross income tax. 45 IAC 1-1-51 (repealed effective January 1, 1999); 45 IAC 1.1-6-2 (effective January 1, 1999). Further, given that no exemption or deduction exists for gross income received in a sham transaction, then the income was still taxable, notwithstanding the disregard for the transaction otherwise for tax purposes.

Taxpayer further protests the imposition of gross income tax with respect to royalties derived from sales to third parties into Indiana and from sales by NC Subsidiary into Indiana. However, Taxpayer, with the relevant information in its hands that would permit it to state its income from sales and income from royalties from Indiana sales, in interstate commerce or otherwise, as opposed to any other source, failed to do so. Accordingly, the Department's assessment has not been shown to be incorrect.

FINDING

Taxpayer's protest is denied.

V. Gross Income Tax-Leasing

DISCUSSION

Leasing Subsidiary argues that the gross income from Leasing Subsidiary's leasing activities is not subject to gross income tax. In particular, Leasing Subsidiary argues that its leasing transactions took place outside Indiana, and accordingly its income is exempt as being in interstate commerce. Ind. Code § 6-2.1-3-3. In particular, Leasing Subsidiary argues that the cases of *Enterprise Leasing Co. v. Ind. Dep't of State Revenue*, 779 N.E.2d 1284 (Ind. Tax 2002) and *First Na'l Leasing & Financial Corp. v. Ind. Dept of State Revenue*, 598 N.E.2d 640 (Ind. Tax 1992) are analogous to Leasing Subsidiary's situation.

Leasing Subsidiary's arrangement differs from the leasing arrangements exempted from taxation in *Enterprise Leasing* and *First National* in one crucial respect. Unlike the lessors in those cases, who could not control where the leased property was transported, *Enterprise Leasing*, 779 N.E.2d at 1290-1293; *First Nat'l Leasing & Financia*, 598 N.E.2d at 643-645, a lessee in Leasing Subsidiary's arrangement could not remove the property from the location designated by the lessee without Leasing Subsidiary's consent. As such, Leasing Subsidiary exerts control of

the property in Indiana sufficient to permit taxation of its gross income derived from leasing its equipment to customers in Indiana.

In the alternative, Leasing Subsidiary argues that it is subject to tax treatment as a qualified lessor under Ind. Code § 6-2.1-1-9(a)(2). Under that provision, a taxpayer that:

> (A) Acquires title to tangible personal property solely for the purpose of leasing it to others;
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> (B) Has no other purpose of ownership in the property; and
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> (C) Leases the property to another under a lease agreement which has a term of at least five (5) years and which requires the lessee to make rental payments, over the term of the lease, equal to the sum of: (i) the cost of the property, plus (ii) finance charges.

is considered a qualified lessor. Accordingly, under Ind. Code § 6-2.1-1-9(b), a qualified lessor is only subject to gross income tax on "the excess of the total rental payments received under a lease described in subsection (a) over the cost of the tangible personal property so leased."

However, Ind. Code § 6-2.1-1-9(e) states:

> A taxpayer that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, an individual or other organization that manufactures, or is engaged in the business of selling, as a distributor or at wholesale or retail or otherwise, property covered by any lease agreement described in subsection (a), is not a qualified lessor**.**

Here, Taxpayer and Leasing Subsidiary are parent and subsidiary; therefore, Leasing Subsidiary is controlled by Taxpayer. Taxpayer manufactures and sells the equipment that Leasing Subsidiary leases. Accordingly, Leasing Subsidiary does not qualify for treatment as a qualified lessor.

FINDING

Taxpayer's protest is denied.

VI. Adjusted Gross Income Tax-Property factors

DISCUSSION

Taxpayer further protests the inclusion of the value of Leasing Subsidiary's leased property in Taxpayer's property numerator. Taxpayer argues that, under the Tax Court's holding in *Enterprise Leasing*, Taxpayer is required to own *and* use the property in question in order for the property to be included in its property numerator for adjusted gross income tax purposes.

Under Ind. Code § 6-3-2-2(c),

> [t]he property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the taxable year. However, with respect to a foreign corporation, the denominator does not include the average value of real or tangible personal property owned or rented and used in a place that is outside the United States. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals. The average of property shall be determined by averaging the values at the beginning and ending of the taxable year, but the department may require the averaging of monthly values during the taxable year if reasonably required to reflect properly the average value of the taxpayer's property.

First, a review of the audit report with respect to Taxpayer shows minimal changes to Taxpayer's property factors, which leads to the assumption that Taxpayer believed that the leased property was owned and used by it in Indiana.

Second, if the Department accepts Taxpayer's argument, it leads to a potentially absurd result. Taxpayer is based outside Indiana. It leases its property to Indiana customers. The property in question is owned by Taxpayer. However, Taxpayer does not use the property anywhere. The acceptance of Taxpayer's argument leads to leased property being in no state's numerator and every state's denominator— a disturbing violation of the overarching policy of the Uniform Division of Income for Tax Purposes Act (UDITPA). *See Twentieth Century Fox Film Corp. v. Dep't of Revenue*, 700 P.2d 1035, 1037 (Or. 1985). (The basic purpose of UDITPA is to tax exactly 100% of a corporations' income) While Indiana has not explicitly adopted UDITPA, Indiana's statutes closely track UDITPA.

Taxpayer clearly owns the leased property. The leased property is in Indiana. To prevent the absurd result that Taxpayer asks us to reach, an either-or approach-"owned", or "rented and used" with respect to the "owned or rented and used in this state" is the only logical construction that can result in Taxpayer's situation. Accordingly, the property should be included in Taxpayer's numerator.

Further, even accepting Taxpayer's argument, under Leasing Subsidiary's arrangement, a lessee in Leasing Subsidiary's arrangement could not remove the property from the location designated by the lessee without Leasing Subsidiary's consent. As such, Leasing Subsidiary has a degree of control over the property— uses the property, though it is in the hands of a third party— within Indiana within the meaning of Ind. Code § 6-3-2-2(c).

Finally, even if Taxpayer's argument is to be accepted with respect to the numerator, Leasing Subsidiary's leased property is not owned *and* used by it anywhere, and accordingly is not part of the equal and opposite statutory inclusion in the denominator as provided by statute. Accordingly, if Taxpayer's argument with respect to the numerator is accepted, the property must also be removed from Taxpayer's denominator.

FINDING

Taxpayer's protest is denied.

VII. Tax Administration--Penalty

DISCUSSION

Taxpayer argues that it is not subject to negligence penalties with respect to the additional taxes assessed against it. In particular, Taxpayer argues that the additional tax was due to its different, but reasonable, interpretation of the statute. Accordingly, it argues that it was not negligent in its tax returns for the years in question.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. Ind. Code § 6-8.1-10-2.1. The Indiana Administrative Code further provides:

> (b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.
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> (c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
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> (2) judicial precedents set by Indiana courts;
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> (3) judicial precedents established in jurisdictions outside Indiana;
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> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
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> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

45 IAC 15-11-2.

Taxpayer has acted in a manner with respect to the tax laws of this state that leads the Department to believe that its actions were a negligent disregard of those laws at best. Accordingly, the penalty must stand.

FINDING

Taxpayer's protest is denied.

JR/JM 051910